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(1)



In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 419

A. E. STALEY, JR., EXECUTOR OF THE ESTATE OF
A. E. STALEY, SR., DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 38-47) is reported at 47 B. T. A. 260. The opinion of the circuit court of appeals (R. 162-165) is reported at 136 F. 2d 368.

JURISDICTION

The judgment of the circuit court of appeals was entered on June 15, 1943 (R. 165-166), and the petition for rehearing denied on July 17, 1943 (R. 171). The petition for writ of certiorari

was filed October 8, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTION PRESENTED

Where, in making gifts of stock in trust to his children in 1934, the father specified in the trust instruments that \$150,000 out of the first income was to be paid to him, and that amount was actually distributed to the father in 1935, was such amount properly included in the father's gross income for 1935?

STATUTE INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual except that—

* * * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, * * * but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows (R. 39-45):

A. E. Staley, Sr., referred to as the decedent, determined to make a gift of the stock of his controlled corporation in trust for the benefit of each of his five children. It was ascertained that the transfer of the proposed gifts in trust would entail a gift tax aggregating approximately \$150,000 more than the amount of cash which decedent had available for payment of such tax. He thereupon decided to transfer the stock in trust in such a way as to enable him to raise the \$150,000 necessary for payment of the gift tax. (R. 39.)

On October 18, 1934, decedent executed his five trust instruments and delivered to the trustee, as the corpus of each trust, certificates representing 6,000 shares of common stock and 2,000 shares of preferred stock of the corporation. At the date of these transfers, the common stock had a value of \$42.50 a share and the preferred stock had a value of \$85 per share. (R. 39-40.)

The five trust instruments were identical except as to the named beneficiary, and contained, among other provisions, the following (R. 40-42):

That, Whereas, the Donor has assigned, transferred and delivered to the Trustee the property described in the schedule hereto attached * * * in Trust, however, for the uses and purposes in this instrument set forth and stated.

Now, Therefore, for and in consideration of the sum of Thirty Thousand Dollars (\$30,000.00) to be paid to the Donor, as provided in Article Third, and certain other good and valuable considerations paid by the parties hereto each to the other, receipt of which is by them now severally acknowledged, and in further consideration of the covenants in this instrument to be by said parties respectively kept and performed, it is hereby agreed:

Article Third: Out of the income derived and received by my said Trustee from the Trust Estate, the Trustee shall:

(a) Upon the written approval of the Co-Trustee, pay all taxes, costs and ex-

penses necessary for the preservation and maintenance of said Trust Estate.

(b) Out of the income of said Trust Estate to annually pay to the Trustee two percent (2%) for the services by it rendered as such Trustee, and annually pay two percent (2%) of the income of said Trust Estate to the Co-Trustee so long as said Co-Trustee shall so act as Co-Trustee.

(c) After the Trustee has made the payments in (a) and (b) of this Article Third hereof mentioned, the Trustee shall out of the income by it received up to and including March 15, 1935, pay to the Donor the entire income by it received out of said Trust Estate, in satisfaction of the consideration of Thirty Thousand Dollars (\$30,000.00) as hereinbefore provided, but in no event shall such payment to the Donor exceed the sum of Thirty Thousand Dollars (\$30,000.00).

After March 15, 1935, the said Trustee shall distribute the income from said Trust Estate in the following manner:

(1) After the payment of (a) and (b) aforesaid, it shall pay to * * * [the named beneficiary] out of the income of said Trust Estate the sum of Five Thousand Dollars (\$5,000.00) per annum, accounting from March 15, 1935, all payments of said Five Thousand Dollars (\$5,000.00) shall be paid in such installments as the Trustee shall deem practicable, and all sums annually received as income by said Trustee in excess of said annual payments of Five

Thousand Dollars (\$5,000.00) per annum, shall be by said Trustee annually paid to the Donor until the total sum of said Thirty Thousand Dollars (\$30,000.00) has been paid to the said Donor.

In January 1935, the trustee received five checks of \$7,000 each from the corporation in payment of a dividend on preferred stock of the corporation held in trust. After deducting its commission and certain minor expenses from these dividend checks, the trustee sent its check to decedent in the sum of \$33,600 in partial satisfaction of the aggregate of \$150,000 to be paid under the trust instruments. (R. 44.)

In February 1935, the corporation declared a dividend on common stock and the trustee received an aggregate of \$150,000 in dividends on this stock held in the five trusts. From this dividend payment, the trustee paid decedent the balance of the sum payable under the provisions of the five trusts. (R. 44.)

On or about March 15, 1936, the trustee filed a fiduciary return of income for 1935 in behalf of each of the trusts, reporting therein retained income taxable to the trusts, which included the amounts paid to decedent under the provisions of article third of the trust instruments (R. 44).

Decedent did not report as gross income the \$150,000 received by him in 1935 from the trustee and paid in accordance with the trust instruments (R. 44).

On March 16, 1935, decedent filed a gift tax return for the year 1934 and reported therein the five gifts in trust made in 1934 for the benefit of his children. He excluded from the reported value of the gifts in trust the \$150,000 payable to him under article third of each of the trusts. (R. 44.) The Commissioner determined a deficiency in gift tax liability which the decedent petitioned the Board to redetermine but in doing so the Board held that the sum of \$150,000, representing the aggregate amount of payments under article Third of the trust instruments was properly excluded in computing the value of gifts made by the decedent (R. 45).

The Board held that the \$150,000 paid to the decedent out of the income of the five trusts was taxable to him (R. 47) and found a deficiency due of \$79,300.99 for 1935 (R. 48).

The circuit court of appeals affirmed the Board's decision. (R. 162-166.)

ARGUMENT

1. The court below correctly held that the \$150,000 was income taxable to the decedent. It is clear that such amount was paid to the decedent as income to which he was entitled and not as a return of capital. As both the Board of Tax Appeals and the court held, this is not a case of sale but of one involving gifts in trust with a

reservation of income by the grantor for himself to the extent of \$150,000.¹

As substance not form governs in tax cases, technical niceties should not control in interpreting the trust instruments here. Thus while such instruments refer (R. 40-42) to the "consideration" payable to the decedent, it is obvious that he did not sell \$2,000,000 worth of stock to his children for the inadequate consideration of \$150,000, nor did he make sales in part and gifts in part. The evidence shows that the decedent wished to make gifts of stock to his children but knew that the resulting gift tax would require more cash than he had and, being elderly, did not wish to delay the gifts until dividends, which would be declared in about six months, could be collected. It was suggested that he sell some of the stock either on the open market or to his children but he rejected both plans because the market price was too low and his children did not have the money needed. (R. 120-121, 129.) Accordingly, the decedent met his difficulty by creating a trust and providing in the trust instruments that he should receive income to the extent of

¹ The Board and the court both agreed that the decedent would be taxable under Section 22 of the Revenue Act of 1934, *supra*, but the Board also indicated, as an alternative reason for its holding, that he could be taxed as a preferred beneficiary under Section 162, *supra*. We agree with the Board that both sections are applicable but do not think it necessary to discuss the difference in provisions here.

\$150,000 as earned by the stocks being transferred. It is significant that nothing was to be paid except from income as received.

There is thus no merit to the contention that the amount here was a return of capital in any form. The money was income paid to the decedent at his own direction and under an arrangement made by him at a time when he was the sole owner of the stock and when he could reserve part or all of the income therefrom if he desired. Under established principles of tax law, the income thus reserved was clearly taxable to the decedent. *Bettendorf v. Commissioner*, 49 F. 2d 173 (C. C. A. 8th); *Morton v. Commissioner*, 23 B. T. A. 930, affirmed *per curiam*, 61 F. 2d 1036 (C. C. A. 2d). To the extent of the \$150,000, it seems clear that the trusts were merely conduits set up by the decedent to collect such income for him and pay it over to him. Cf. *Griffiths v. Commissioner*, 308 U. S. 355, and *Minnesota Tea Co. v. Helvering*, 302 U. S. 609. But as the court below held, it is immaterial for tax purposes whether the transactions are regarded as gifts of all the corpus and all income in excess of \$150,000 or whether they are deemed to be gifts in trust with reservation to the donor of a specified portion of trust income as beneficiary. Cf. *White v. Rose*, 73 F. 2d 236 (C. C. A. 5th).

2. There is no conflict in the decisions as alleged by petitioner. *Helvering v. Falk*, 291 U. S. 183, involved a wholly different question. In *Curran v. Commissioner*, 49 F. 2d 129 (C. C. A. 8th),² on which petitioner relies, the taxpayer transferred a building to a corporation in which he was a large stockholder and received what was called a dividend although it lacked several distinguishing features of a dividend. It was held there that the building had been sold, not given, to the corporation, that the money constituted payment for the building, and, since the sum received was less than cost, that the entire sum was a return of capital and not taxable. But in the instant case, the evidence did not establish that a sale had been made or that the sum received represented a return of capital.³

Robert Hoe Estate Co. v. Commissioner, 85 F. 2d 4 (C. C. A. 2d), is also distinguishable. In that case, the devisees of realty under a will, which failed to provide for the widow's dower, formed a corporation to own and manage the realty and made an agreement with the widow under which she released all her interest in the realty and its usufruct, and the corporation promised to pay,

² The *Curran* case was decided 14 days before the same court decided *Bettendorf v. Commissioner*, *supra*, on which we rely, but the former was not discussed in the latter opinion and was evidently not considered as applicable therein.

³ There was also no proof of the cost of the stock (R. 46).

not profits in kind but a sum equal to one-third of the company's net profits from the realty. The court held there that the sum paid to the widow could not be excluded from the taxable income of the corporation, and when paid to the widow represented the cost of acquiring her interest in the property. In this case the decedent did not sell his stock. He merely created a trust reserving the right to receive \$150,000 of the income from the stock.

CONCLUSION

This case presents no question which requires a review by this Court. The petition should be denied.

Respectfully submitted,

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